

DEPARTMENT OF STATE REVENUE

04-20140329.LOF

Letter of Findings Number: 04-20140329
Sales Tax
For Tax Year 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUES**I. Use Tax - Liability.**

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-6; IC § 6-2.5-4-1; IC § 6-2.5-5-1 et seq; IC § 6-8.1-5-1; IC § 6-2.5-5-2; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoades v. Indiana Dept. of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Indiana Dept. of State Revenue v. AOL, 963 N.E.2d 498 (Ind. 2012); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dept. of Revenue v. Kimball International, Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indianapolis Fruit Co. v. Dept. of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998); Indiana Dept. of State Rev. v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Graham Creek Farms v. Ind. Dept. State Revenue, 819 N.E.2d 151 (Ind. Tax Ct. 2004); [45 IAC 2.2-2-1](#); [45 IAC 2.2-5-4](#). IC § 6-2.5-3-2(a); [45 IAC 2.2-3-4](#).

Taxpayer protests the imposition of use tax on the purchase of agricultural machinery.

II. Tax Administration - Negligence Penalty.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer grows sweet corn. Taxpayer purchased equipment to install field tile and provided an exemption certificate to the retail merchant. The Indiana Department of Revenue ("Department") disagreed with the exemption and issued an assessment of use tax on the transaction. The Department also issued an assessment of a ten percent negligence penalty and interest. Taxpayer protested the assessment of use tax and the imposition of the negligence penalty. An administrative hearing was held, and this Letter of Findings results. Additional facts will be provided as needed.

I. Sales Tax - Liability.**DISCUSSION**

Taxpayer protests the assessment of use tax on the purchase of agricultural equipment. All tax assessments are prima facie evidence that the Department's claim for the tax is valid, and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). The issue is whether Taxpayer met its burden to prove the assessment is incorrect.

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a); [45 IAC 2.2-2-1](#). Indiana imposes a complementary use tax on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction" regardless of the merchant's or transaction's location. IC § 6-2.5-3-2(a); [45 IAC 2.2-3-4](#). The use tax is "functionally equivalent to [the] sales tax." Rhoades v. Indiana Dept. of State Revenue, 774 N.E.2d 1044, 1047-48 (Ind. Tax Ct. 2002). "Indeed, the purpose of the use tax is merely to prevent evasion of the sales tax." Indiana Dept. of State Revenue v. AOL, 963 N.E.2d 498, 501 (Ind. 2012). The person who uses, stores, or consumes property acquired in a retail transaction in Indiana is responsible for payment of use tax on the transaction. IC § 6-2.5-3-6(b).

The use tax applies to retail transactions. A retail transaction is a transaction made by a retail merchant that constitutes "selling at retail." IC § 6-2.5-1-2. Selling at retail means a retail merchant "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration" in the ordinary course of the merchant's business. IC § 6-2.5-4-1(b). Tangible personal property is personal property that "can be seen, weighed, measured, felt, or touched" IC § 6-2.5-1-27(1).

Taxpayer concedes that the sensor and control, valves, and power cord ("Equipment") were acquired in a retail transaction, but argues that the transaction is exempt from tax. The legislature has provided specific exemptions from sales tax. IC § 6-2.5-5-1 et seq. However, exemption statutes are strictly construed in favor of taxation. *Indiana Dept. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 524 (Ind. 1983). Whether a taxpayer qualifies for an exemption from tax is "highly fact sensitive," and it is the taxpayer's burden to prove the exemption criteria has been met. *Indiana Dept. of Revenue v. Kimball International, Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

The purchase of agricultural machinery is exempt from sales and use tax "only if the purchaser is occupationally engaged in the business of producing food or commodities for human, animal, or poultry consumption for sale or for further use in such production." [45 IAC 2.2-5-4\(a\)](#). Additionally, the purchase of agricultural machinery is exempt from the sales tax "if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities." IC § 6-2.5-5-2(a).

Therefore, to claim this exemption, a taxpayer must first demonstrate that it produces tangible personal property, as it is clear that "without production there can be no exemption." *Indianapolis Fruit Co. v. Dept. of State Revenue*, 691 N.E.2d 1379, 1384 (Ind. Tax Ct. 1998). Second, a taxpayer must demonstrate that it is "occupationally engaged in the business of producing food or commodities for human, animal, or poultry consumption for sale or for further use in such production." [45 IAC 2.2-5-4\(a\)](#). Finally, a taxpayer must show that the agricultural equipment or machinery was acquired for the "direct use in the direct production, extraction, harvesting, or processing of agricultural commodities." IC § 6-2.5-5-2(a).

Taxpayer produces sweet corn. Therefore, it is undisputed that Taxpayer is both engaged in the business of producing food and actually does produce food. The remaining issue is whether the Equipment was acquired for the "direct use in the direct production, extraction, harvesting, or processing of agricultural commodities." IC § 6-2.5-5-2(a).

Courts have recognized that the legislature's "repetition of the requirement that the use be direct" was intended to provide for a narrow construction of the exemption. *Indiana Dept. of State Rev. v. RCA Corp.*, 310 N.E.2d 96, 100 (Ind. Ct. App. 1974). To be considered directly used in direct production of agricultural commodities, the Equipment "must have an immediate effect on the article being produced." [45 IAC 2.2-5-4\(e\)](#). "Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces agricultural products." *Id.* Whether property is essential and integral to an integrated process is determined "by identifying the points where production begins and where it ends." *Indianapolis Fruit*, 691 N.E.2d at 1384; see also, *Graham Creek Farms v. Ind. Dept. State Revenue*, 819 N.E.2d 151, 156 (Ind. Tax Ct. 2004). "The fact that a piece of equipment is convenient, necessary, or essential to farming is insufficient in itself to determine if it is used directly in direct production as required to be exempt." [45 IAC 2.2-5-4\(e\)](#).

Taxpayer argues that the Equipment is exempt because it is agricultural equipment used in growing crops. Specifically, Taxpayer states that the Equipment "is used for the installation of farm field tile," and "field tile is one of the most important improvements one can make in the pursuit of growing an elite crop." However, as noted, "[t]he fact that a piece of equipment is convenient, necessary, or essential to farming is insufficient in itself to determine if it is used directly in direct production as required to be exempt." [45 IAC 2.2-5-4\(e\)](#). Taxpayer has not demonstrated that the Equipment is directly used in direct production of agricultural commodities and has not met its burden to show that the Department's assessment is incorrect. Taxpayer's protest is respectfully denied.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration - Negligence Penalty.

DISCUSSION

Taxpayer protests the Department's proposed assessment of a penalty. All tax assessments are *prima facie*

evidence that the Department's claim for the tax is valid, and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). The issue is whether Taxpayer met its burden to prove the assessment is incorrect.

A taxpayer who "incurs, upon examination by the department, a deficiency that is due to negligence . . . is subject to a penalty." IC § 6-8.1-10-2.1(a). The Department shall waive the penalty if the taxpayer demonstrates that the failure to pay the outstanding taxes "was due to reasonable cause and not due to willful neglect." IC § 6-8.1-10-2.1(d); see also [45 IAC 15-11-2](#). The taxpayer may demonstrate reasonable cause by showing affirmatively that it used "ordinary business care and prudence" in not paying the outstanding taxes. However, a taxpayer's ignorance of Indiana's tax laws does not constitute reasonable cause. Whether a taxpayer demonstrates reasonable cause for penalty purposes is a fact-sensitive question and determined on a case-by-case basis. [45 IAC 15-11-2](#)(b) and (c).

Taxpayer has demonstrated that he acted reasonably in failing to pay the outstanding sales tax. Taxpayer's protest of the penalty is sustained. However, Taxpayer is now aware of its sales tax obligations and that penalty may be imposed if this scenario occurs again.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest is respectfully denied on Issue I regarding assessment of sales tax on the purchase of agricultural machinery. Taxpayer's protest is sustained on Issue II regarding the imposition of a penalty.

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